



HOUSING PRESERVATION NEWS

CHPC Preservation Clearinghouse

Elyse Perry,
Program Coordinator
Ph:(415) 433-6804 x13
Email:
eperry@chpc.net

Matt Schwartz
Executive Director
Ph:(415) 433-6804 x11
Email:
mschwartz@chpc.net

How to contact us:

MAIN OFFICE

369 Pine Street Suite 300
San Francisco, CA 94104
Ph: (415) 433-6804
Fax: (415) 433-6805

INLAND EMPIRE

28545 Old Town
Front Street, Suite 205
Temecula, CA 92590
Ph: (951) 506-3377
Fax: (951) 506-3997

LOS ANGELES

800 South Figueroa
Street, Suite 760
Los Angeles, CA 90017
Ph: (213) 892-8775
Fax: (213) 892-8776

SACRAMENTO

PO Box 8132
5325 Elkhorn Blvd.
Sacramento, CA 95842
Ph: (916) 683-1180
Fax: (916) 683-1194

SAN DIEGO

PO Box 319
113 West G Street
San Diego, CA 92101
Ph: (858) 693-1572
Fax: (951) 506-3997

Rehabilitation of Aging HUD Properties: The Preservation of Martinelli House

Editor's Note: Developers built thousands of affordable apartments throughout the country in the 1970s with the assistance of HUD's Section 236 subsidized mortgage program. California is home to 82 such properties providing affordable housing to some 9,000 very low-income households. Much of this aging housing stock is nonprofit owned, meaning that there is a lower risk of conversion to market-rate. However, many of these developments suffer from substantial deferred maintenance accumulated over the last 30 years, leading to a significant risk of another kind: the physical deterioration of the buildings. This issue of Housing Preservation News highlights the refinancing and rehabilitation of one such example and tells the story of some of the obstacles that CHPC helped its owner overcome along the way.

The Property and the Need for Substantial Rehabilitation

Marin Housing Corporation, a Mercy Housing affiliate, developed Martinelli House more than 30 years ago, using a HUD Section 236 reduced interest rate loan and later a later contract for federal Section 8 rental subsidies for 28 of the 66 studio and one-bedroom apartments. Martinelli House is a single, high-rise elevator building on well-landscaped grounds in San Rafael. Over the years, many of Martinelli House's tenants "aged in place," so that by 2006, the majority of Martinelli residents were extremely low-income, frail seniors, with no real housing alternatives in Marin County's expensive rental market. As resident physical and social needs grew more complex and operating expenses rose, Mercy found it difficult to maintain Martinelli at its usual high standards. In addition, the tenants' need for ADA accommodations increased over time, and Martinelli House, like so many buildings developed in the 1970s, did not include sufficient accommodations for the disabled. In this context, Mercy concluded it needed to refinance Martinelli House in order to renew it physically by overhauling all major building systems as well as to make significant ADA upgrades to improve residents' quality of life.

Refinancing Goals & Strategy for Aging Nonprofit-Owned HUD Properties

In addition to meeting the property's physical needs, Mercy also wanted to recoup as much of its own sunk capital costs as possible without using a substantial amount of scarce resources. This meant trying to maximize the use of noncompetitive or less scarce resources. Mercy structured the refinancing as a sale from its affiliate to a limited partnership in which another affiliate serves as the general partner. The use of this structure made Martinelli House eligible for both acquisition and rehabilitation Low Income Housing Tax Credits. While the property's need for substantial rehabilitation might have justified the use of 9% Tax Credits, the property did not technically qualify as "at-risk." (Even had it qualified for this valuable and scarce subsidy, Mercy would not have wanted to compete against other properties that are at much greater risk due to the possibility of their owners converting them to market rate.) Instead, Mercy chose to raise the required capital through a combination of (currently noncompetitive) tax exempt debt, noncompetitive 4% Tax Credits, Affordable Housing Program funds from the Federal Home Loan Bank, a loan from the local redevelopment Agency, income from operations, and most importantly, a seller take-back loan and grant (again, made possible by the transfer of the property from the affiliate to the limited partnership). Mercy chose not to pursue the decoupling and recasting of the Interest Reduction Payment (IRP) loan that came as part of the original Section 236 mortgage. Mercy made this decision with input from HUD that the time required to process the IRP would create additional risk that would not be compensated for by the relatively modest financial benefits of separating and recasting the few years of IRP subsidy remaining.

Financing Details

On paper, the full development cost of Martinelli House’s rehabilitation – including the partnership’s cost of acquiring it from the nonprofit affiliate, construction and soft costs – is \$11.5 million, but \$3.7 million of this should be netted out since it is both a source of financing (the Seller Note and a grant from Mercy) and a use (part of the acquisition price). The net development cost for Martinelli was therefore approximately \$7.8 million. However, the refinanced property would only be able to support permanent debt of approximately \$2.6 million, leaving a gap of \$5.2 million to fill. By obtaining an allocation of tax-exempt bonds from the California Debt Limit Allocation Committee (CDLAC), Mercy qualified the property to receive an allocation of 4% Tax Credits, which generated approximately \$4.7 million in investor payments. Mercy was then able to close the remaining gap by obtaining a \$320,000 award of Affordable Housing Program (AHP) funds from the Federal Home Loan Bank and combining it with a \$100,000 soft loan from the San Rafael Redevelopment Agency and income from operations during the construction period.

Uses of Funds	Amount	Sources of Financing	Construction Amount	Permanent Amount
Acquisition	4,069,602	Citibank Tax-Exempt Bonds	6,000,000	2,559,200
Construction	4,306,401	Seller Note (Marin Housing Corporation)	3,527,385	3,527,385
Architect/Design/Eng	374,000	Federal Home Loan Bank - AHP	320,000	320,000
Costs of Issuance	230,640	Income from Operations	136,875	136,875
Marketing/Reserves	296,812	San Rafael Redevelopment Agency	100,000	100,000
Legal/Other Consultants	169,174	Mercy Housing Grant	200,000	200,000
Relocation	380,000	Costs Deferred Until Completion	704,479	0
Developer Fee	1,008,598	Tax Credit Equity	542,937	4,688,216
Other Soft Costs	696,449			
Total Development Cost	11,531,676	Total Sources	11,531,676	11,531,676

Timing posed a significant challenge for this transaction. While the requests for various HUD approvals for the transaction were pending, CHPC helped Mercy secure the allocation of tax-exempt bonds and 4% Tax Credits in December 2006. With a deadline to issue the bonds by March 2007, several unanticipated delays in obtaining the HUD approvals (including approval of the Section 236 mortgage prepayment; approval of the seller “carry-back” note; and approval of the Section 8 contract assignment, with concurrent approval of increased, budget-based Section 8 rents and a new, 20-year contract) rapidly became critical-path items. Fortunately, Mercy’s partners – Citibank (providing both construction and permanent financing), Union Bank of California (the equity partner), the San Rafael Redevelopment Agency, and the San Francisco HUD office – worked together to ensure a successful outcome.

Mercy Housing is now concluding the full rehabilitation of Martinelli House. With CHPC’s help and the creative, flexible thinking shown by Mercy and its project partners, Martinelli House will be preserved as high quality affordable housing for at least another 30 years. Though Martinelli House is in no danger of losing its affordability status, many Section 236 properties are still at risk of converting to market rate as HUD mortgages reach maturity and original Section 8 rental assistance contracts expire. These properties may be owned by nonprofit housing organizations, or they may be owned by profit-motivated entities or non-housing-driven nonprofit organizations wishing to cash out their interests. The refinancing and rehabilitation strategy used by Mercy provides a useful road map for preserving long-term affordability in maturing HUD properties.